Good Tech Contract > No Tech Contract > Bad Contract

BY RICK SANDERS

AARON SANDERS
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Technology lawyers like to talk about how exciting and dynamic technology is--how complex, confusing and counter-intuitive it can be. And, of course, we like to talk about how important it is for everyone to know about it.

At the same time, a technology-based business is still a business, and that means it must also deal with what we might call "boring" law: contract formation and enforcement, sale of goods, stuff like that. It's not dynamic and exciting, and I doubt very much there is a blawg dedicated to, say, contract enforcement. But it can be just as important.

The Halloween 2011 decision handed down by the Tennessee Court of Appeals in *ICG Link, Inc. v. Steen,* et al., is a case in point. The case is about a Middle-Tennessee technology-reliant business that asked a local web designer to re-build its website, and how a failure to appreciate "boring law" ended up making both sides feel pretty burned. And this case could have been so much worse with just a slight alteration of the facts.

Build Me a Website, Sirrah!

The individual defendant in this case, Philip Steen, started and operated co-defendant Nashville Sports Leagues ("NSL"), which organizes a number of recreational sports leagues. An important part of the business was coordinating activities for and providing information to NSL's customers and the public. Obviously, a website is just the thing for that; indeed, NSL operated a website, which was becoming an increasingly important part of its business. Steen organized an LLC, called "TN Sports, LLC" to operate NSL.

NSL used to have a guy in-house who was responsible for building and operating the website (we'll call him the "Guy"), but he left to go work for ICG Link, which apparently is how Steen's relationship with ICG Link developed. NSL naturally outsourced its website operations to ICG Link. The website was, at this point, already pretty old. NSL was becoming very successful, which meant the old website was straining under increasing loads. It wasn't long before ICG Link was recommending a complete re-build of the site, and Steen had to agree. Unfortunately, the Guy wasn't at ICG Link anymore, so ICG Link assigned another employee (whom we'll call "Another Guy") to the project.

Another Guy sent Steen what he called a "quote," setting forth a large number of features to be included in the website (the "Quote"). These features were described in a generic way, *e.g.*, "Site Design," "Main Template Layout," "Database Layout." For each of these items, the quote set out a number of hours (in .5 increments). At the end of the Quote, Another Guy multiplied the total number of hours by the rate of $85/hour, for a total of $12,622.50. ICG Link intended the Quote to be an estimate, but Steen understood it to be a flat fee. The Quote didn't include any other terms.

The opinion doesn't say much about how Another Guy went about building the new website. By the time the lawsuit was filed, Another Guy had left

2400 Crestmoor Road, Nashville, TN 37215 • p 615-385-2690 • m 615-482-4038 • rick@aaronsanderslaw.com

ICG Link (of course). At trial, ICG Link had an expert testify that Another Guy had built the site using PHP5, which seems perfectly acceptable. Steen had an expert testify that Another Guy had built the site using Smarty, which was described as a "shorthand version of PHP … intended to be used for very small projects." He further opined that Smarty was inappropriate for the new website, but the opinion doesn't say why.*

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* *Smarty is more typically described as a web template system for PHP. I'll defer to the web developers out there, but I don't see why Smarty was inherently a wrong choice for the new NSL website.*

A few months later, the new site wasn't quite finished, but ICG Link and Steen agreed to launch it. Immediately, Steen was unhappy. He said it was a pain for him to use because he found it cumbersome to add data to the site, which was a problem because Steen was constantly adding and changing data, *e.g.*, scores, schedules, standings, rosters and the like. Steen also that complained user accounts got duplicated, and it was difficult for users to navigate, among other user-side problems.

Steen wouldn't pay in full for the website, though he made a few payments. He seems not to have complained directly to ICG Link, but instead he hired another firm plus an additional consultant to review ICG Link's work. Those consultants agreed that it'd cost more to fix the problems than to build an even newer website. Meanwhile, ICG Link responded to Steen's non-payment by slow-walking the project. Steen went ahead and told his consultants to build the new, new website. A few months later, Steen told ICG that NSL was taking its business elsewhere.

ICG Link eventually sued to recover about $30,000 in unpaid invoices. It named as defendants both NSL and Steen personally. NSL countersued for the amount it cost for his consultant to review ICG Link's work and for the cost of the new website (which was about $20,000). NSL's theory was that the new website was so bad, it violated the "contract" between NSL and ICG.

Contract? What Contract?

The trial court and the appellate court agreed that both ICG Link and NSL had a major problem with their legal theories: There was no contract between the parties. The law maintains something of a legal fiction that a contract arises when there is a "meeting of the minds."* Unfortunately, when the relationship goes to heck, no one can quite remember what it was that the parties agreed to, and that beautiful, perfect moment when the parties' minds met is lost forever.

* *You can think of a contract as a kind of a Zen or Platonic concept. It exists in the abstract, "out there" somewhere, but somehow ultimately unknowable. Instead, we must rely on evidence–writings and (if allowed) oral remembrances–to piece together what really happened when the "minds met," an imperfect, sublunary approximation of the perfect, quintessential contract. In this way of thinking, if the contract has been reduced to writing, the writing isn't the "contract" (though it's called that); it's just the best evidence of the contract's terms (and definitive evidence if the contract is well and thoughtfully drafted).*

In this case, the court held that there wasn't enough evidence to show that the parties' minds ever met. Specifically, there wasn't enough evidence to show what NSL thought it was getting in exchange for the $12,622.50.* Somehow, just saying that you'll be spending 40 hours on "Site Design," 18 hours on "Main Template Layout" and another four hours on "Database Layout" isn't good enough. One suspects that Another Guy had a good sense of what he would be doing and would be delivering with each of those items. The problem was that he didn't tell Steen–and Steen (or anyone in Steen's position) would have no idea. It was like saying, "For $12,622.50, I will give you a car that has wheels, an engine and a drive-train. It could be a Yugo. It could be a Maserati."

* *The court seemed to assume that the quoted price of $12,622.50 was the actual contract price (or, would have been, had there actually been a contract). I'm not sure I'm convinced. While the price set forth in a "quote" will often be the contract price (if a contract is formed), in this case, it looks a lot like an estimate. Another Guy was primarily providing the number of hours for each stage of the project, and I think most people know that these are usually estimates. The reason why website developers (and for that matter lawyers) bill by the hour is that it's really hard to predict with any certainty how long a project will really take. Still, Another Guy could have avoided the whole problem by, you know, calling it an "Estimate."*

So, fine, there's no contract, but now we have a weird situation. Another Guy did offer to build a website, Steen said OK, Another Guy built it (and apparently went way over-budget). Does this mean that NSL doesn't need to pay ICG Link anything?

You Get What You Deserve. And That's All.

No. That would be an anomalous result, and the law has a way of dealing with situations like this when two parties behave as though they were under some sort of contract but no contract was, in fact, formed. This concept goes by several names: quasi-contract,* *quantum meruit* ("the amount that is deserved") and unjust enrichment. The idea is that if you perform a service for someone, it's clear you're not doing it as a favor, and the other person accepts and benefits from your service, the law will find some way to compensate you, even if there's no contract.

* *Most people make a Hunchback of Notre Dame joke here. I'll spare you.*

So, ICG Link gets to collect the entire $30,000 in open invoices? Again, no. Quasi-contract is an imperfect substitute for an enforceable contract because it uses an entirely different method of calculating damages. In a contract case, ICG Link would have gotten whatever NSL agreed to pay, no matter how bad a bargain it would have been for NSL. Under that theory, ICG Link would have received about $30,000. (There was actually some dispute about the hourly rate.) But under quasi-contract, the court is supposed to conduct an independent inquiry into the actual value of the services rendered. Given what was delivered, what would a reasonable person have paid?

The appellate court held that no reasonable person would have paid $30,000 for the new website. Although the website was functional, it had a lot of problems. Most important, it was too difficult for Steen to use efficiently, and there were some other problems.

The parties didn't put on any proof about the value of the new website. Fortunately for the court, Steen and ICG Link's president had a testy email exchange on that subject, with Steen writ-

ing that the new website was worth $15,000. The court seized on that and held that ICG Link's damages were $15,000, less any payments NSL had made, less whatever NSL had spent on the consultants it hired to review the new website's problems. When all was said and done, the damages were all of $8842.50.

It Could Have Been Worse

ICG Link could easily have lost the case–and been liable for NSL's damages–had "Another Guy" (the ICG employee who issued the "Quote") been slightly more forthcoming to Steen about the details of his work, and Steen been able to point to any contractual term spelling out any utility standards for the new website. Recall that, while Steen had a number of complaints about the website, his main complaint was that it was too hard to add new data to the website, and adding new data was crucial to his business. Luckily for ICG Link, Steen apparently never mentioned this to Another Guy, either in a phone conversation or in writing.

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Had the Quote been found definite enough to form a contract, it would have been a mischievous document for ICG Link. Just because there's a written "contract" doesn't mean that the writing contains all of the contract's terms. Unless the written document contains a term (known as an "integration clause") that explicitly limits the contract to the "four corners" of the written document, the court can find additional (or even different) terms based on oral testimony of the parties, whose memories are going to be colored by the current dispute. Even if the Quote had contained one of these "integration clauses," the Quote would have been so indefinite that the court would have allowed testimony in order to flesh out the contract's terms, which is almost as bad.

The other risk ICG Link took was assuming that Steen understood the Quote to be an estimate, even though it was called a "quote" and the word estimate wasn't ever used. The appellate court appeared to assume without deciding that the $12,622.50 set forth in the Quote was the contract price, but that issue wasn't before the court. But if the court had found that a contract existed, it could easily have decided that $12,622.50 was the contract price, and ICG Link would have received even less than the $15,000 it won (less the deductions I discussed above).

It Could Have Been *a Lot* Worse

Steen is the one who really dodged a bullet, though, with the finding of no contract. If Another Guy had described the proposed website with more clarity, Steen could have been on the hook for the full $30,000 in open invoices. While the court appeared to assume without deciding that the $12,622.50 was the contract price (which would have been a good result for Steen), that issue wasn't before the court. Had the court been forced to decide the issue, it could easily have come out the other way. While the Quote didn't use the word estimate, it provided time periods associate with each task, which it then added up and multiplied by a billing rate. I think a lot of people would have interpreted that as an estimate

because most people know it's difficult or impossible to state precisely how long a project will take.

In that case, Steen would have ended up with the web equivalent of a $30,000 paper weight (except that a real paper weight could at least hold down paper). But it gets worse under this scenario because he wouldn't have been able to deduct the amount he spent trying to fix the website. Under the quasi-contract theory, the appellate court deducted that amount from the $15,000 because it represented a real reduction in objective value of the website. If you have to pay $1000 on consultants to get your website to function, then logically website's value is $1000 less.

But if there had been a contract, the court wouldn't have done that. That's because under a contract, the you're stuck with whatever bargain you struck. So, if the court found that Steen agreed to pay $85 an hour (as opposed to $12,622.50 total) for a website with certain features, and no mention were made of the data-entry requirements, Steen would have been forced to accept the imperfect website because that's what he contracted for. He might have realized later that he needed a better interface for entering data, but by then it would have been too late. ICG Link would have given him what he "wanted." The time to require standards for data entry would have been during negotiations, before a contract was formed.

There's probably a limit to how "bad" the contract would have gotten for Steen. Although $12,622.50 probably isn't the contract price for the website development, it's still an estimate, at Steen was entitled to rely on it to some extent. It was, after all, provided by one in the business of making such estimates, and Steen could plausibly argue that he wouldn't have entered into the contract if the "estimate" had been accurate (*i.e.*, much higher). A court wouldn't have capped the damages at $12,622.50 because Steen should have known it could have been low. But a court would probably cap damages at some amount higher than $12,622.50--how much higher would depend on how what a reasonable person in Steen's position would have understood the upper limit of the estimate to be.

Both sides would have benefited from a "good" contract–one that actually reflected what each party wanted and expected. Both sides got lucky and avoided accidentally forming a "bad" contract–one whose terms are unstable and full of unpleasant surprises. They ended up with no contract. Thus, in this case, a good contract is better than no contract, and no contract was better than a bad contract.

The Challenge of IT Contracts

The Tennessee Court of Appeals was cognizant of the challenges of technology contracts:

> This dispute highlights, as one legal scholar puts it, "the unique characteristics of information technology" and the impact these characteristics can have in an otherwise ordinary dispute over unpaid invoices. Michael D. Scott, Scott on Information Technology Law § 1.01 (2010). Scott writes:
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> > Contracting for computer-related services is theoretically no different from contracting for other types of goods or services. . . . [However,] Computer industry technology can be confusing and often ambiguous. To add to the normal confusion experienced by the neophyte,

> the computer industry has the . . . habit of using terminology in an ambiguous manner, taking everyday words and giving them entirely new meanings, and inventing words to suit its needs. While this creates problems even for those knowledgeable in the industry, it creates additional problems for inexperienced buyers, their counsel, and the judges who must sort out conflicting claims in any contract litigation. Id. § 7.01.

Problems can be exacerbated by the fact that most businesses heavily rely on information technology to operate, and typically the software developer is the only entity with the knowledge to repair defects, especially in custom-designed software. As Scott observes, "[b]ecause of the potential for confusion, misunderstanding, and dissatisfaction that can result from the development of software that does not meet the expectations of the parties, it is incumbent upon the parties to carefully spell out . . . the procedure by which the final software product will be developed . . . ." Id. § 10.04. Scott emphasizes especially the need to express the parties' respective obligations when a change to a program is requested, because "[o]ften what appears to the customer to be a minor change necessitates a major rewrite on the part of the [developer]." Id. § 10.05(B). He also suggests a payment schedule based on the completion of defined "modules" of the website. Id. § 10.05(C). Ownership of certain "generic modules," or modules that can be reused in other websites, as well as ownership of data and both parties' proprietary information are also likely to be areas of contention if not addressed prior to performance. Id. § 10.05(D).

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In some ways, though, ICG Link's risk wasn't nearly as big as Steen's because ICG Link could control whether a dispute arose or not. In other words, for ICG Link, the problem was as much a business (or customer-relations) problem as it was a legal problem. With some better communication on ICG Link's part, and maybe a bit more work, the whole episode could have been avoided. In that respect, ICG Link's legal risk is perhaps acceptable. The worst that can happen is it doesn't get paid, and only then if the customer is unhappy.*

** Unless the technology provider gets itself on the hook for "consequential" (or downstream) damages, in which case it could be in for loads of trouble. If the provider knows how and why the project is important to the customer, the provider could be liable for all foreseeable damages resulting from its breach of contract, such as lost profits. That could be a lot. Fortunately, this is an avoidable problem with a modicum of legal advice.*

For Steen, though, the problem was 100% legal. He needed a good contract to protect his interests. It was far more important to him than to ICG Link that the contract spell out the minimum requirements and features of the new website. Without out it, he was really as ICG Link's mercy. Luckily, NSL had enough cash to build a replacement website

without missing a beat, but a smaller company might not have been able to. And yet, technology providers are much more likely than technology consumers to insist on written, fully integrated contracts–and guess who is more likely to benefit from those form contracts?

Why Did I Form an LLC, Then?

Oh, and the court held that, Steen was personally liable for the judgment, even though he had organized an LLC and sincerely believed he was acting on the LLC's behalf when he had these dealings with ICG Link. Why?

Given how much the damages had been reduced, this may not make much of a difference if NSL is otherwise solvent–it can always reimburse its CEO. But it still should surprise several of you. Steen had gone to the trouble of forming an LLC. Isn't the point of forming an LLC to avoid personal liability for contract damages.

Yes, yes it is. But it's not enough just to form the LLC (or corporation or whatever). You have to act like you're the manager/CEO/President/whatever of the LLC. Steen didn't do this. All ICG Link knew was that it was dealing with "Nashville Sports Leagues." Recall that "Nashville Sports League" wasn't the name of Steen's LLC. It was just the name his LLC was doing business as. But for all ICG Link knew, it was just the name of Steen's personal business. After all, a sole proprietor can do business under any name.

It was up to Steen to make clear that the actual party ICG Link was dealing with was his LLC. Normally, people in Steen's situation will fix the problem by putting the LLC name in the written contract. But, here, there wasn't a written contract (or any contract). Thus, if you are operating a small business, it is up to you to make sure that the people you do business with know (1) the legal name of your business, and (2) that you are acting on its behalf, not on your own behalf. It doesn't take much…. For example, make a habit of telling potential business contacts what company you're working for, and talk terms of what your company will do, rather than what "I" will do.

Thanks for reading!

RICK SANDERS (RICK@AARONSANDERSLAW.COM) IS A PARTNER AT AARON & SANDERS, PLLC, IN NASHVILLE, TENNESSEE.